

Fiscal Services Division

Legislative Services Agency

Fiscal Note

HF 555 - Cigarette/Tobacco Tax Increases (LSB 1799 HV)

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Fiscal Note Version – New

Description

House File 555 increases the cigarette tax rate from \$0.36 per pack of 20 cigarettes to \$1.36 per pack and increases the tobacco tax rate from 22.0% of the wholesale cost to 83.0% of the wholesale cost. The Bill also provides that tax receipts from the increase (\$1.00 per pack on cigarettes and 61.0% on tobacco) be deposited in the Healthy Iowans Tobacco Trust (HITT) Fund while \$0.36 per pack of cigarettes and the 22.0% tax on tobacco products be deposited in the General Fund. The Bill increases the tax rates upon enactment.

Background

The cigarette tax was last increased in 1991 when it was raised from \$0.31 per pack to the current rate of \$0.36 per pack. The tobacco tax was also increased that year, moving from 19.0% to 22.0% of the wholesale price.

Under current law, the Revenue Estimating Conference (REC) projects gross cigarette tax revenues to be \$89.5 million in FY 2008 and \$90.4 million in FY 2009. Gross tobacco tax receipts are projected to be \$9.7 million in FY 2008 and \$10.0 million in FY 2009.

Assumptions

Cigarette Tax:

- The retail price of a pack of cigarettes is \$3.64.
- Iowa currently loses about 8.8% of cigarette tax revenue due to various types of evasion. The rate of tax evasion following the rate change is assumed to equal 18.35%.
- Based on research, a \$1.00 per pack (27.5%) increase in price has an elasticity equal to negative 0.7. Overall demand due to the tax increase is estimated to decrease by 19.2%.
- Preemptive buying equal to 21.5% of normal purchases is assumed to occur over the month and a half preceding the rate change and offsetting reductions in purchases are spread over six months following the rate change. Although this Bill is effective upon enactment, preemptive buying is still expected to occur prior to the tax increase.
- The assumed effective date for the rate change is April 1, 2007.
- Fiscal Year 2009 cigarette demand is assumed to decline by 1.0% from the previous year (prior to the tax change).
- The increase in the cost of cigarettes will have a higher negative impact on the sale of cigarettes in Iowa border communities.

Tobacco Tax:

- Assumes the same assumptions used for cigarettes in regards to tax evasion and early purchasing rates due to an increase in tax.
- A retail margin of 20.0% over the wholesale price is assumed for tobacco products (other than cigarettes).
- The demand price elasticity assumed for a tax rate change from 22.0% to 83.0% of the wholesale price (equivalent to a 21.1% retail price increase) equals negative 0.70. Overall demand due to the tax increase is estimated to decrease 35.0%.
- The assumed effective date for the rate change is April 1, 2007.

Sales Tax (State, Local Option Sales Tax (LOST), and School Infrastructure Local Option Sales Tax (SILO):

- Due to the cigarette/tobacco tax increase, demand is estimated to decrease nearly 20.0% from the pre-tax increase projections. However, the overall sales taxable cost of the products is increasing, offsetting much of the decreased demand.
- Tax evasion is estimated at 8.8%.
- Statewide, the percent of local option sales tax (LOST) is assumed to remain at the FY 2006 level of 0.69% and the School Infrastructure Local Option Sales Tax (SILO) is assumed to remain at 0.95%.

FY 2007 General Fund and Healthy Iowans Tobacco Trust Fund:

- Cigarette and Tobacco tax receipts will be deposited in both the General Fund and the Healthy Iowans Tobacco Trust Fund upon enactment which is assumed to be April 1, 2007. Changes to the General Fund are based on FY 2007 and FY 2008 REC projections for Cigarette and Tobacco taxes. Impacts on the General Fund in FY 2009 assume a 1.0% decrease from FY 2008 REC projections for the cigarette tax and a 2.1% increase for the tobacco tax.

Fiscal Impact

Overall impacts to the cigarette tax, tobacco tax, sales tax (including Local Option Sales Tax (LOST) and School Infrastructure Local Option (SILO) Sales tax), General Fund, and Healthy Iowans Tobacco Trust (HITT) Fund are provided below.

Cigarette Tax Impact:

Cigarette tax receipts will increase above current REC estimates. The receipts will be divided between the General Fund and the Healthy Iowans Tobacco Trust (HITT) Fund. The overall impact in revenues generated from the increase in the cigarette tax is an additional \$32.7 million in FY 2007, \$129.4 million in FY 2008, and \$134.0 million in FY 2009 (see table below).

FY 2007			
	Estimated FY07 Current Law	Estimated FY07 HF 346	Estimated Impact FY07
General Fund	\$ 89,500,000	\$ 82,780,161	\$ - 6,719,839
HITT Fund	\$ 0	\$ 39,397,379	\$ 39,397,379
Cigarette Tax Total	\$ 89,500,000	\$ 122,177,539	\$ 32,677,539

FY 2008			
	Estimated FY08 Current Law	Estimated FY08 HF 346	Estimated Impact FY08
General Fund	\$ 90,400,000	\$ 58,192,550	\$ - 32,207,450
HITT Fund	\$ 0	\$ 161,645,974	\$ 161,645,974
Cigarette Tax Total	\$ 90,400,000	\$ 219,838,524	\$ 129,438,524

FY 2009			
	Estimated FY09 Current Law	Estimated FY09 HF 346	Estimated Impact FY09
General Fund	\$ 89,500,000	\$ 59,164,059	\$ - 30,335,941
HITT Fund	\$ 0	\$ 164,344,610	\$ 164,344,610
Cigarette Tax Total	\$ 89,500,000	\$ 223,508,669	\$ 134,008,669

Tobacco Tax Impact:

Tobacco tax receipts will increase above current REC estimates. The receipts will be divided between the General Fund and the Healthy Iowans Tobacco Trust (HITT) Fund. The overall impact in revenues generated from the increase in the tobacco tax is an additional \$3.7 million in FY 2007, \$10.7 million in FY 2008, and \$11.2 million in FY 2009.

FY 2007			
	Estimated FY07 Current Law	Estimated FY07 HF 346	Estimated Impact FY07
General Fund	\$ 9,700,000	\$ 8,721,067	\$ - 978,933
HITT Fund	\$ 0	\$ 4,684,280	\$ 4,684,280
Tobacco Tax Total	\$ 9,700,000	\$ 13,405,347	\$ 3,705,347

FY 2008			
	Estimated FY08 Current Law	Estimated FY08 HF 346	Estimated Impact FY08
General Fund	\$ 10,000,000	\$ 5,480,525	\$ - 4,519,475
HITT Fund	\$ 0	\$ 15,196,001	\$ 15,196,001
Tobacco Tax Total	\$ 10,000,000	\$ 20,676,526	\$ 10,676,526

FY 2009			
	Estimated FY09 Current Law	Estimated FY09 HF 346	Estimated Impact FY09
General Fund	\$ 10,210,000	\$ 5,680,429	\$ - 4,529,571
HITT Fund	\$ 0	\$ 15,750,279	\$ 15,750,279
Tobacco Tax Total	\$ 10,210,000	\$ 21,430,708	\$ 11,220,708

Sales Tax Impact:

The estimated change in the State sales tax revenue will impact the General Fund. The amounts displayed for LOST and SILO represent statewide totals. The overall impact of the state sales tax (\$0.05 rate) is an increase of \$0.8 million in FY 2007, a decrease of \$0.6 million in FY 2008, and a decrease of \$0.7 million in FY 2009.

	FY07	FY08	FY09
Estimated Change in Sales Tax (General Fund Revenue)	\$ 754,769	\$ - 616,543	\$ - 685,833
Estimated Change in Local Option Sales Tax (LOST)	\$ 104,158	\$ - 85,083	\$ - 94,645
Estimated Change in School Infrastructure Local Option Sales Tax (SILO)	\$ 143,406	\$ - 117,143	\$ - 130,308

Overall General Fund Impact:

The Bill provides that upon enactment, the \$0.36 portion of the \$1.36 cigarette tax and the tobacco tax rate of 22% be deposited in the General Fund. Because of a decrease in demand outlined in the assumptions, General Fund revenues will decrease from REC projections (estimated for FY 2009) by \$6.9 million in FY 2007, \$37.3 million in FY 2008, and \$35.6 million in FY 2009.

Estimated General Fund Impact			
	Estimated Change in General Fund FY07	Estimated Change in General Fund FY08	Estimated Change in General Fund FY09
Cigarette Tax Impact	\$ - 6,719,839	\$ - 32,207,450	\$ - 30,335,941
Tobacco Tax Impact	\$ - 978,933	\$ - 4,519,475	\$ - 4,529,571
Sales Tax Impact	\$ 754,769	\$ - 616,543	\$ - 685,833
Total G.F. Impact	\$ - 6,944,004	\$ - 37,343,468	\$ - 35,551,345

Overall Healthy Iowans Tobacco Trust (HITT) Fund Impact:

The Bill provides that upon enactment, the \$1.00 portion of the \$1.36 cigarette tax and the tobacco tax rate of 61% be deposited in the HITT Fund. The increase in taxes will increase the amount deposited in the HITT Fund by \$44.1 million in FY 2007, \$176.8 million in FY 2008, and \$180.1 million in FY 2009.

Estimated Healthy Iowans Tobacco Trust Fund (HITT) Impact			
	Estimated HITT Fund FY07	Estimated HITT Fund FY08	Estimated HITT Fund FY09
Cigarette Tax Impact	\$ 39,397,379	\$ 161,645,974	\$ 164,344,610
Tobacco Tax Impact	\$ 4,684,280	\$ 15,196,001	\$ 15,750,279
Total HITT Fund Impact	\$ 44,081,659	\$ 176,841,975	\$ 180,094,889

Sources

Iowa Department of Revenue
Revenue Estimating Conference Tax Receipt Projections
Campaign for Tobacco Free Kids, *State Cigarette Prices, Taxes, and Costs per Pack*
LSA Calculations

/s/ Holly M. Lyons

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The fiscal note and correctional impact statement for this bill was prepared pursuant to Joint Rule 17 and pursuant to Section 2.56, Code of Iowa. Data used in developing this fiscal note and correctional impact statement are available from the Fiscal Services Division, Legislative Services Agency to members of the Legislature upon request.
